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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D. C. 20548

FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 A.M. EST
NOVEMBER 14, 1973

STATEMENT OF
ELMER B. STAATS, COMPTROLLER GENERAL
OF THE UNITED STATES
BEFORE THE
SUBCOMMITTEE ON PRIORITIES AND ECONOMY IN GOVERNMENT
JOINT ECONOMIC COMMITTEE

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

I AM PLEASED TO APPEAR BEFORE THIS SUBCOMMITTEE TODAY.
MY STATEMENT WILL COVER SOME OF OUR RECENT WORK ON FEDERAL
PROCUREMENT.

OFFICE OF FEDERAL PROCUREMENT POLICY

IN VIEW OF YOUR SUBCOMMITTEE'S INTEREST FOR MANY YEARS
IN IMPROVING THE PROCUREMENT PROCESS IN THE FEDERAL GOVERN-
MENT AND INDUSTRY, WE WOULD LIKE TO FIRST BRING YOU UP TO
DATE ON THE STATUS OF PROPOSED LEGISLATION TO CARRY OUT
THE RECOMMENDATION OF THE COMMISSION ON GOVERNMENT PROCURE-
MENT TO ESTABLISH AN OFFICE OF FEDERAL PROCUREMENT POLICY.

AS YOU KNOW, A THREE YEAR EFFORT WAS RECENTLY COMPLETED
BY THE COMMISSION, CREATED BY THE CONGRESS, OF WHICH I WAS
A MEMBER, DEVOTED ENTIRELY TO A STUDY OF GOVERNMENT PROCURE-
MENT. THROUGH THIS EFFORT, WE FOUND A WIDESPREAD CONSENSUS

*Procurement Policies and Procedures in the Acquisition
of Major Weapons Systems 7-20657*

AT BOTH THE GRASS-ROOTS AND HIGHEST LEVELS IN GOVERNMENT AND INDUSTRY OF THE NEED FOR A FOCAL POINT IN THE EXECUTIVE BRANCH TO EXERCISE LEADERSHIP IN (1) FORMULATING AND COORDINATING BASIC PROCUREMENT POLICIES AND (2) OVERSEEING THEIR IMPLEMENTATION IN A PROCUREMENT PROCESS WHICH NOW INVOLVES THE EXPENDITURE OF MORE THAN \$50 BILLION ANNUALLY. IT WAS FOUND ALSO THAT A CENTRAL POINT OF LEADERSHIP WAS NEEDED TO WORK WITH THE CONGRESS IN MODERNIZING AND CONSOLIDATING THE PRESENT FRAGMENTED STATUTORY BASE AND TO DEVELOP A MORE UNIFORM REGULATORY SYSTEM AMONG THE MANY FEDERAL AGENCIES WITH EXTENSIVE PROCUREMENT ACTIVITIES.

THE COMMISSION ENVISIONED AN OFFICE OF FEDERAL PROCUREMENT POLICY PLACED AT A HIGH LEVEL IN GOVERNMENT. THE OFFICE WOULD ACT AN AN IMPARTIAL SPOKESMAN IN PROCUREMENT MATTERS BEFORE THE CONGRESS.

IT IS OUR POSITION THAT LEGISLATION IS VITAL IN ORDER TO PROVIDE A CONGRESSIONAL MANDATE FOR ACTION AND TO PROVIDE THE FOCAL POINT OF PROCUREMENT POLICY LEADERSHIP WITH THE STATURE, AUTHORITY AND CALIBER OF PERSONNEL NECESSARY TO GET THE JOB DONE. MR. CHAIRMAN, WE WILL BE TESTIFYING TOMORROW ON THE NEED FOR THIS LEGISLATION BEFORE SENATOR CHILES' AD HOC SUBCOMMITTEE ON FEDERAL PROCUREMENT. MANY OF THE PROBLEMS WE WILL BE DISCUSSING TODAY COULD BE AMELIORATED OR AVOIDED IF A STRONG POINT OF LEADERSHIP HAD EXISTED IN THE EXECUTIVE OFFICE OF THE PRESIDENT. I HOPE THE LEGISLATION WILL HAVE THE SUPPORT OF THIS COMMITTEE.

BUILD AND CHARTER PROGRAM

THE NAVY ENTERED INTO A LONG-TERM (20-YEAR) LEASING ARRANGEMENT ON JUNE 20, 1972, BY HAVING THE JOINT VENTURE OF MARINE TRANSPORT LINES, INC.; CITICORP LEASING, INC.; AND SALOMON BROTHERS OBTAIN THE FUNDS TO FINANCE THE CONSTRUCTION OF NINE TANKERS WITH NAVY'S GUARANTEE THAT IT WOULD LEASE THEM. FOUR TANKERS ARE BEING BUILT BY TODD SHIPYARDS CORPORATION AND FIVE ARE BEING BUILT BY BATH IRON WORKS CORPORATION.

GAO MADE THE REVIEW TO DETERMINE

- WHETHER THE NAVY'S ACTION WAS THE MORE ECONOMICAL METHOD TO MEET ITS NEEDS;
- WHETHER OR NOT THE CONGRESS HAD AN OPPORTUNITY TO CONSIDER THE WISDOM OF THE TRANSACTION BEFORE THE FORMAL COMMITMENT TO SPEND FUTURE FUNDS; AND
- WHETHER REVIEW AND APPROVAL BY THE CONGRESS SHOULD BE REQUIRED FOR FUTURE TRANSACTIONS OF THIS TYPE.

PRIOR TO FORMALIZING THE LEASING ARRANGEMENT, THE PROPOSED FINANCIERS ASKED US TO RULE ON THE LEGALITY OF USING OPERATION AND MAINTENANCE FUNDS TO PAY THE LEASE COSTS. OUR DECISION WAS THAT USE OF OPERATION AND MAINTENANCE FUNDS INSTEAD OF PROCUREMENT FUNDS WAS NOT ILLEGAL SINCE TITLE TO THE SHIPS WOULD NEVER PASS TO THE GOVERNMENT AND THEREFORE DID NOT RESULT IN THE PURCHASE OF AN ASSET.

IN FURNISHING A COPY OF THIS DECISION TO THE SECRETARY OF DEFENSE WE SUGGESTED, THAT IN VIEW OF THE MAGNITUDE OF THE PROGRAM, IT WOULD BE DESIRABLE TO INFORM THE HOUSE AND SENATE COMMITTEES ON ARMED SERVICES AND APPROPRIATIONS OF THE PLANS BEFORE GOING FORWARD. THE NAVY TOLD US THAT THEY ADVISED THE COMMITTEES INFORMALLY.

ACCORDING TO THE LATEST AVAILABLE ESTIMATE, THE TOTAL LEASE COSTS WILL BE APPROXIMATELY \$313 MILLION OVER THE 20-YEAR LEASE PERIOD BEGINNING IN FISCAL YEAR 1975. THE COST TO PURCHASE THE TANKERS, LESS THE RESIDUAL VALUE, WOULD HAVE BEEN \$136 MILLION. HOWEVER, AS YOU KNOW, WHETHER LEASING IS MORE ECONOMICAL THAN PURCHASING DEPENDS ON THE DISCOUNT RATE USED TO CONVERT FUTURE DOLLARS INTO TODAY'S VALUE. THE NAVY BELIEVES THAT THE APPROPRIATE DISCOUNT RATE IS 10 PERCENT AS PRESCRIBED IN DOD INSTRUCTIONS AND OMB CIRCULAR A-94. CIRCULAR A-94 PRESCRIBES THE DISCOUNT RATE FOR EVALUATING GOVERNMENT DECISIONS CONCERNING THE INITIATION, RENEWAL, OR EXPANSION OF PROGRAMS OR PROJECTS. HOWEVER, A-94 STATES THAT ITS PROVISIONS DO NOT APPLY TO THE EVALUATION OF GOVERNMENT DECISIONS CONCERNING THE ACQUISITION OF COMMERCIAL-TYPE SERVICES AND THAT GUIDANCE FOR MAKING SUCH DECISIONS IS CONTAINED IN CIRCULAR A-76. OMB CIRCULAR A-76 CRITERIA FOR VALUING MONEY IS THE AVERAGE

YIELD ON LONG-TERM DEPARTMENT OF THE TREASURY OBLIGATIONS. THIS RATE, AT THE TIME THE TRANSACTION WAS ENTERED INTO, WAS ABOUT 6 PERCENT.

LET ME CONTRAST THE DIFFERENCE IN COST TO THE GOVERNMENT USING THE CRITERIA SET FORTH IN THE TWO OMB CIRCULARS. IT WOULD COST THE GOVERNMENT \$178.1 MILLION MORE TO LEASE RATHER THAN PURCHASE THE SHIPS IF DISCOUNTING WERE DISREGARDED. BY USING THE 6 PERCENT RATE WHICH WOULD HAVE BEEN APPROPRIATE AT THE TIME UNDER A-76 CRITERIA, IT WOULD COST \$29.6 MILLION MORE TO LEASE THAN TO PURCHASE. BY USING THE 10 PERCENT DISCOUNT RATE PRESENTED IN OMB CIRCULAR A-94, IT IS ESTIMATED TO COST \$10.4 MILLION LESS TO LEASE THAN TO PURCHASE THE TANKERS. THESE DATA ARE GRAPHICALLY PRESENTED AT ATTACHMENT I.

AS A RESULT OF OUR REVIEW, WE RECOMMENDED THAT THE SECRETARY OF DEFENSE REVISE DOD INSTRUCTIONS TO PROVIDE FOR APPLICATION OF THE GUIDELINES SET FORTH IN CIRCULAR A-76, IN EVALUATING LONG-TERM LEASING OF ASSETS SUCH AS SHIPS. WE ALSO RECOMMENDED THAT TO IMPROVE CONGRESSIONAL AWARENESS OF SIMILAR PROGRAMS THE SECRETARY OF DEFENSE SHOULD ASSIST THE CONGRESS BY

--PROVIDING IT WITH INFORMATION ON THE PROPOSED
METHOD OF ACQUISITION,

--PROVIDING DETAILED COST ANALYSIS SHOWING FULL
IMPACT ON FUTURE BUDGETS, AND
--REQUIRING ANALYSES OF LONG-TERM LEASING ARRANGE-
MENTS TO BE MADE ON A TOTAL-COST-TO-THE GOVERNMENT
BASIS.

WE ALSO SUGGESTED THAT, SINCE THE NAVY'S BUILD AND
CHARTER PROGRAM IS SIMILAR TO GOVERNMENT PROGRAMS FOR
LEASING BUILDINGS, THE CONGRESS MAY WISH TO CONSIDER THE
NEED FOR LEGISLATION SIMILAR TO PUBLIC LAW 92-313. THIS
LAW REQUIRES CONGRESSIONAL APPROVAL OF ALL BUILDING LEASES
COSTING MORE THAN \$500,000 A YEAR.

WE HAVE BEEN ADVISED THAT THE NAVY IS CURRENTLY CON-
SIDERING A SIMILAR ARRANGEMENT FOR ACQUIRING THE USE OF TWO
DRY CARGO-TYPE SHIPS. BECAUSE THE BUILD AND CHARTER PROGRAM
CAN BE CONSIDERED AS SETTING A PRECEDENT, LEGISLATION COULD
BE AN EFFECTIVE TOOL TO INSURE CONGRESSIONAL REVIEW OF FUTURE
LONG-TERM LEASING PROGRAMS.

SELECTED ACQUISITION REPORTS

IN FEBRUARY 1968, THE DEPARTMENT OF DEFENSE ESTABLISHED THE SELECTED ACQUISITION REPORT (SAR) REQUIREMENT. BEFORE THE SYSTEM WAS INTRODUCED, THERE WERE NO SUMMARY RECURRING REPORTS ON MAJOR ACQUISITIONS WHICH PROVIDED A COMPARISON OF CURRENT COST, SCHEDULE, AND PERFORMANCE DATA WITH PRIOR ESTIMATES. DOD INSTRUCTIONS PROVIDE THAT SARs ARE REQUIRED FOR ALL PROGRAMS DESIGNATED AS MAJOR BY THE SECRETARY OF DEFENSE AND WILL USUALLY BE THOSE PROGRAMS WHICH REQUIRE A TOTAL OF \$50 MILLION FOR DEVELOPMENT AND TESTING OR \$200 MILLION FOR PROCUREMENT.

THE SELECTED ACQUISITION REPORTS DO PROVIDE SUMMARY DATA FOR THE CONGRESSIONAL COMMITTEES AND CONGRESSMEN FACED WITH CRITICAL DECISIONS ON MAJOR WEAPONS ACQUISITIONS. WE BELIEVE, HOWEVER, THAT THERE ARE A NUMBER OF CHANGES THAT CAN AND SHOULD BE MADE TO FURTHER IMPROVE THE UTILITY OF THESE REPORTS. THESE ARE:

--MORE PRECISE CRITERIA SHOULD BE ESTABLISHED FOR INCLUDING MAJOR ACQUISITIONS FOR SAR REPORTING. DOD INSTRUCTIONS PROVIDE THAT SARs ARE REQUIRED FOR ALL PROGRAMS DESIGNATED AS MAJOR BY THE SECRETARY OF DEFENSE AND WILL USUALLY BE THOSE PROGRAMS WHICH REQUIRE A TOTAL OF \$50 MILLION FOR RDT&E OR \$200 MILLION FOR PROCUREMENT. OTHER SYSTEMS NOT QUALIFYING UNDER THESE DOLLAR GUIDELINES MAY BE DESIGNATED FOR SAR COVERAGE BY THE SECRETARY.

THOUGH CRITERIA FOR SAR REPORTING SHOULD INCLUDE DOLLAR LIMITATIONS, THE ABOVE DOLLAR CRITERIA BY THEMSELVES MAY PRECLUDE SYSTEMS CRITICAL TO THE NATIONAL DEFENSE FROM BEING INCLUDED OR EVEN FROM BEING CONSIDERED FOR SAR REPORTING SOLELY ON THE BASIS OF MINIMUM DOLLAR LIMITATIONS. THUS THE URGENCY OF NEED SHOULD ALSO BE INCLUDED IN THE CRITERIA FOR SAR REPORTING. IN ADDITION, FACTORS SHOULD BE INCLUDED IN THE CRITERIA TO SPECIFY WHEN IN THE ACQUISITION PROCESS SYSTEMS SHOULD BE ADDED OR DELETED.

DOD HAS NO FORMAL PROCESS FOR DECIDING WHETHER A MAJOR SYSTEM SHOULD BE INCLUDED IN THE SAR SYSTEM. WE WERE INFORMED THAT SYSTEMS ARE SELECTED FOR THE SAR SYSTEM ON THE BASIS OF RECOMMENDATIONS FROM THE SERVICES OR OSD AND/OR ON THE BASIS OF INTEREST IN A SYSTEM BY THE CONGRESS OR GAO.

--ESTABLISHING AND MAINTAINING FIRM BASELINES FOR MAJOR ACQUISITIONS MUST BE MANDATORY IN ORDER TO IMPROVE THE SAR AS A KEY INFORMATION REPORT. TO MEASURE PROGRAM PROGRESS, MANAGEMENT MUST HAVE A BASELINE. AT THE OUTSET OF ANY PROGRAM, A PLANNING ESTIMATE IS ESTABLISHED AND PERIODICALLY CHANGES AS THE PROGRAM PROGRESSES. THE INITIAL PLANNING ESTIMATES COULD BE REPORTED AS RANGES OF DOLLARS AND

SHOULD REMAIN ON THE SAR FOR TRACKING PURPOSES.

A SIMILAR APPROACH COULD BE TAKEN WITH THE DEVELOPMENT ESTIMATE. IT COULD BE LABELED AS "INITIAL" AND STATED AS RANGES OF PROBABLE COST UNTIL THE DEVELOPMENT CONTRACT WAS AWARDED. SUBSEQUENTLY, THE DEVELOPMENT ESTIMATE SHOULD REMAIN STATIC.

ADDING A PRODUCTION ESTIMATE TO SARs SHOULD ALSO BE CONSIDERED. THIS WOULD BE "INITIAL" UNTIL THE PRODUCTION PHASE BEGINS, AND WOULD BECOME STATIC ONCE THE PRODUCTION CONTRACT IS AWARDED.

--THE SARs SHOULD BE SUBMITTED TO THE CONGRESS AND MANAGEMENT OFFICIALS IN THE DEPARTMENT OF DEFENSE ON A MORE TIMELY BASIS IN ORDER TO FACILITATE INTELLIGENT DECISION-MAKING. BECAUSE OF WHAT APPEAR TO BE AN INORDINATE NUMBER OF REVIEW LEVELS BOTH WITHIN THE SERVICES AND THE OFFICE OF THE SECRETARY OF DEFENSE, SARs ARE NOW BEING ISSUED FROM 3-4 MONTHS AFTER THE CLOSE OF THE PERIOD COVERED. IN OUR OPINION, THIS DELAY IS NOT NECESSARY AND COULD, ON OCCASION, RESULT IN A FAILURE TO TAKE APPROPRIATE ACTIONS AT AN EARLY DATE.

--ALL PROGRAM COSTS SHOULD BE INCLUDED ON THE SARs BEGINNING WITH THE INITIAL ISSUANCE OF A SAR FOR A PARTICULAR PROGRAM. AT THE PRESENT TIME, SARs FOR WEAPONS PROGRAMS IN THE DEVELOPMENT STATE OFTEN DO NOT INCLUDE AN ESTIMATE OF THE TOTAL PRODUCTION COSTS. WE BELIEVE THAT THE CONGRESS AND DOD MANAGEMENT ARE LIMITED IN THEIR ABILITY TO MAKE INTELLIGENT DECISIONS, EVEN DURING THE DEVELOPMENT PHASE, IF THEY DO NOT HAVE SOME ESTIMATE OF THE TOTAL PROGRAM COST. IN ADDITION, SUCH LIMITATION OF COST REPORTING CAN RESULT IN SOME PROGRAMS NOT BEING REPORTED ON THE SARs FOR SUBSTANTIAL PERIODS OF TIME BECAUSE THEY DO NOT MEET COST CRITERIA.

ALSO, AT THE PRESENT TIME, NUCLEAR WARHEAD COSTS ARE NOT INCLUDED IN THE TOTAL PROGRAM COSTS BECAUSE THEY ARE FUNDED BY THE ATOMIC ENERGY COMMISSION. AT OUR URGING, SUCH COSTS HAVE BEEN INCLUDED AS A "FOOTNOTE" ITEM ON THE SARs, BUT CAN BE OVERLOOKED BY A READER. SINCE THESE COSTS CAN BE SUBSTANTIAL, WE BELIEVE THEY SHOULD BE INCLUDED IN THE TOTAL PROGRAM COST ESTIMATES AS SHOWN ON THE SAR.

OUR LETTER OF OCTOBER 30, 1973, ON THIS SUBJECT TO THE CHAIRMAN, COMMITTEE ON ARMED SERVICES, HOUSE OF REPRESENTATIVES IS ATTACHMENT II TO MY STATEMENT.

FINANCIAL STATUS REPORTS ON SELECTED ACQUISITIONS

OUR LATEST REPORT ON THE FINANCIAL STATUS OF SELECTED MAJOR WEAPON SYSTEMS HAS JUST BEEN ISSUED. THIS REPORT DETAILS THE COST CHANGES OF \$2.7 BILLION REPORTED ON 45 MAJOR WEAPON SYSTEMS BETWEEN DECEMBER 31, 1972, AND JUNE 30, 1973. THE TOTAL ESTIMATED COSTS AMOUNTED TO \$122.4 BILLION ON DECEMBER 31, 1972, AND \$125.1 BILLION ON JUNE 30, 1973. THE NET INCREASE OF \$2.7 BILLION IS MADE UP OF DECREASES IN DEVELOPMENT ESTIMATES TOTALING \$.2 BILLION, QUANTITY DECREASES TOTALING \$.1 BILLION AND COST INCREASES RELATING TO OTHER FACTORS TOTALING \$3.0 BILLION.

IN THE FUTURE, WE PLAN TO CONTINUE SUBMITTING FINANCIAL STATUS REPORTS ON MAJOR ACQUISITIONS ON A SEMI-ANNUAL BASIS. THE REPORT ON THE STATUS AS OF DECEMBER 31, WILL BE ISSUED IN MAY OF EACH YEAR AND THE JUNE 30 STATUS REPORT WILL BE ISSUED IN NOVEMBER OF EACH YEAR.

EVALUATIONS OF SELECTED MANAGEMENT FUNCTIONS WILL BE MADE AND REPORTS ISSUED AS THE EVALUATIONS ARE COMPLETED IN LIEU OF COMBINING AN ASSESSMENT OF MANAGEMENT ACTIONS AND FINANCIAL STATUS IN A SINGLE ANNUAL REPORT.

THE SCHEDULE AND PERFORMANCE DATA WILL BE REPORTED IN OUR STAFF STUDIES ON INDIVIDUAL SYSTEMS, AS IN THE PAST.

SHOULD-COST STUDIES

IN TESTIMONY BEFORE THIS SUBCOMMITTEE LAST DECEMBER, WE DISCUSSED THE RESULTS OF OUR ASSESSMENT OF SELECTED SHOULD-COST STUDIES OF CONTRACTORS' OPERATIONS WHICH WERE PERFORMED BY THE ARMY. SINCE THAT TIME WE HAVE ISSUED REPORTS ON OUR ASSESSMENTS OF SHOULD-COST STUDIES PERFORMED BY THE NAVY AND THE AIR FORCE. WE HAVE ALSO COMPLETED CERTAIN FOLLOW-UP WORK ON THE ARMY AND NAVY STUDIES WHICH YOU REQUESTED IN YOUR JULY 24, 1973, LETTER. I WILL BRIEFLY SUMMARIZE THE RESULTS OF THIS WORK TODAY AND THE REPORT ON THIS WORK WILL BE ISSUED TO YOU IN THE VERY NEAR FUTURE.

WE BELIEVE THAT, AS A RESULT OF THE INTEREST SHOWN BY THIS SUBCOMMITTEE IN THE SHOULD-COST APPROACH, THE MILITARY DEPARTMENTS HAVE TAKEN A MORE ACTIVE ROLE IN REVIEWING THE OPERATIONS OF GOVERNMENT CONTRACTORS. THE NAVY, HOWEVER, HAS FALLEN BEHIND THE ARMY AND THE AIR FORCE IN ITS USE OF THE SHOULD-COST APPROACH. FOR EXAMPLE, ONLY THREE OF THE MORE THAN FIFTY SHOULD-COST STUDIES CONDUCTED TO DATE INVOLVED NAVY PROCUREMENTS.

ALTHOUGH MANY IMPROVEMENTS RECOMMENDED BY THE SHOULD-COST TEAMS CANNOT BE QUANTIFIED, IF THESE IMPROVEMENTS ARE ADEQUATELY IMPLEMENTED BY THE CONTRACTORS, THE BENEFITS COULD BE SUBSTANTIAL. WHILE PROGRESS HAS BEEN MADE, MUCH REMAINS TO BE DONE TO MAKE THE RESULTS OF THE SHOULD-COST

STUDIES EVEN MORE PRODUCTIVE. OUR REPORTS CONTAIN A NUMBER OF RECOMMENDATIONS DESIGNED TO ENCOURAGE IMPROVEMENTS IN THE MILITARY SERVICES' USE OF THIS APPROACH IN THE FUTURE.

THE ARMY ADVISED US THAT IT FULLY CONCURRED IN THE CONTENTS OF OUR OCTOBER 30, 1972, REPORT, AND THAT IT HAD INITIATED A NUMBER OF SPECIFIC ACTIONS TO ASSURE FULL IMPLEMENTATION OF OUR RECOMMENDATIONS. AS PART OF OUR FOLLOW-UP WORK, WE INQUIRED INTO THE PROGRESS MADE BY THE SIX ARMY CONTRACTORS WHO AGREED TO WORK TOWARD CERTAIN MANAGEMENT IMPROVEMENT GOALS. WE FOUND THAT THE CONTRACTORS HAD MADE IMPROVEMENTS IN MOST OF THE AREAS IDENTIFIED BY THE ARMY. FOR EXAMPLE, REDUCTIONS WERE MADE IN MANUFACTURING, ASSEMBLY AND FABRICATION LABOR HOURS, AND IN INDIRECT COSTS. ALSO, IMPROVEMENTS WERE MADE IN PRODUCTION CONTROLS AND MAKE-OR-BUY PROCEDURES.

FOLLOWING COMPLETION OF THE AIR FORCE STUDIES WHICH ARE DISCUSSED IN OUR JULY 31, 1973, REPORT, THE AIR FORCE ISSUED GUIDANCE FOR USE ON FUTURE SHOULD-COST STUDIES WHICH, IF PROPERLY IMPLEMENTED, SHOULD CORRECT MOST OF THE DEFICIENCIES WE FOUND. ACTIONS HAVE ALSO BEEN PROMISED BY THE AIR FORCE WITH RESPECT TO THE OTHER MATTERS DISCUSSED IN OUR REPORT.

SINCE 1967, WHEN THE FIRST SHOULD-COST STUDY WAS MADE ON THE TF-30 JET ENGINE PROCUREMENT, THE NAVY HAS MADE ONLY TWO OTHERS. THESE CONCERNED THE OPERATIONS OF TWO CONTRACTORS

WHICH WERE COMPETING FOR PRODUCTION OF THE MARK 48 TORPEDO. OUR ASSESSMENT WHICH IS DISCUSSED IN OUR MAY 15, 1973 REPORT, WAS DIRECTED PRIMARILY TO THE STUDY OF THE OPERATIONS OF THE CONTRACTOR WHICH WAS ULTIMATELY AWARDED THE FIRST PRODUCTION CONTRACT IN JULY 1971.

ALTHOUGH OUR FOLLOW-UP WORK INDICATES THAT THE MARK 48 CONTRACTOR HAS MADE IMPROVEMENTS IN HIS OPERATIONS IN EACH OF THE AREAS IN WHICH THE SHOULD-COST TEAM CONSIDERED IN NEED OF ATTENTION, WE COULD NOT QUANTIFY SAVINGS DIRECTLY RELATED TO EACH OF THE SHOULD-COST RECOMMENDATIONS. WE FOUND THAT THE MARK 48 TORPEDO COSTS AND PRICES HAVE CONTINUED TO DECLINE SINCE THE INITIAL PROPOSALS FOR THE FIRST PRODUCTION CONTRACT. ALSO, THE CONTRACTOR IS CURRENTLY PROJECTING A COST UNDERRUN OF ABOUT \$7.7 MILLION ON THE FIRST PRODUCTION CONTRACT.

THE NAVY HAS RECENTLY ISSUED A MEMORANDUM INTENDED TO PROVIDE GUIDANCE TO ITS PROCUREMENT ACTIVITIES WITH RESPECT TO MAKING SHOULD-COST STUDIES. WE DO NOT BELIEVE THE POLICY STATEMENT WILL ENCOURAGE THE NAVY'S INCREASED USE OF SHOULD-COST STUDIES. IT MAY BE USEFUL TO DISCUSS THE REVISED POLICY WITH NAVY REPRESENTATIVES WHEN THEY APPEAR BEFORE THE COMMITTEE.

BASED ON OUR ASSESSMENTS OF THE SHOULD-COST STUDIES THAT HAVE BEEN PERFORMED BY THE MILITARY SERVICES, IT SEEMS CLEAR THAT THERE IS GREAT POTENTIAL FOR THE GOVERNMENT TO BENEFIT FROM THE PROPER APPLICATION OF SHOULD-COST CONCEPTS. THE CRITERIA FOR SELECTING PROCUREMENTS FOR STUDY AND DECISIONS REGARDING THE SCOPE AND TIMING OF THE STUDIES HAVE BEEN LEFT LARGELY TO THE INDIVIDUAL SERVICES TO DETERMINE. IN LIGHT OF THE CONSIDERABLE EXPERIENCE GAINED BY THE MILITARY SERVICES IN CONDUCTING SHOULD-COST STUDIES IN RECENT YEARS, WE BELIEVE THE DEPARTMENT OF DEFENSE SHOULD TAKE A MORE ACTIVE ROLE IN ESTABLISHING THE CRITERIA AS TO WHEN SHOULD-COST STUDIES SHOULD BE MADE AND IN MONITORING THE EFFECTIVENESS OF THE STUDIES.

ARCHITECT & ENGINEERING SERVICES (A/E)

IN PREVIOUS APPEARANCES BEFORE THIS COMMITTEE, WE DISCUSSED THE GOVERNMENT'S CONTRACTING FOR A/E SERVICES. SINCE THAT TIME LEGISLATION ON A/E SERVICES HAS BEEN ENACTED AND THE COMMISSION ON GOVERNMENT PROCUREMENT STUDIED THE SUBJECT. THE COMMISSION RECOMMENDED THAT:

- THE BASIS FOR PROCUREMENT OF A/E SERVICES, SO FAR AS PRACTICABLE, SHOULD BE COMPETITIVE NEGOTIATIONS, TAKING INTO ACCOUNT THE TECHNICAL COMPETENCE OF THE PROPOSERS, THE PROPOSED CONCEPT OF THE END PRODUCT, AND THE ESTIMATED COST OF THE PROJECT, INCLUDING FEE.
- LIFE-CYCLE COST ESTIMATES SHOULD BE INCLUDED IN A/E CONTRACTS ON PROJECTS ESTIMATED TO COST IN EXCESS OF \$500,000.
- CONSIDERATION SHOULD BE GIVEN TO REIMBURSING A/E'S FOR COSTS INCURRED IN SUBMITTING PROPOSALS WHERE UNUSUAL DESIGN PROBLEMS ARE INVOLVED AND SUBSTANTIAL WORK IS NEEDED TO SUBMIT PROPOSALS.

IN LIGHT OF THE COMMISSION'S FINDINGS AND RECOMMENDATIONS AND IN LIGHT OF RECENT PRESS COVERAGE CONCERNING A/E CONTRACTING AT THE STATE AND LOCAL LEVEL, WE ARE UNDERTAKING A REVIEW OF THE PROCEDURES FOLLOWED BY FEDERAL AGENCIES IN THE PROCUREMENT OF A/E SERVICES.

SELECTED SUBCONTRACTING ACTIVITIES
AT LITTON'S PASCAGOULA SHIPYARD

AS YOU KNOW, THERE HAD BEEN ALLEGATIONS THAT OFFICERS AND EMPLOYEES OF LITTON INDUSTRIES, INGALLS SHIPBUILDING DIVISION, PASCAGOULA, MISSISSIPPI, ENGAGED IN ILLEGAL OR IMPROPER ACTIVITIES INCLUDING THE TAKING OF FEES AND KICK-BACKS FROM SUBCONTRACTORS.

YOUR JANUARY 2, 1973, LETTER TO US INDICATED THAT THERE WERE ALLEGATIONS OF IMPROPRIETIES AND IRREGULARITIES IN BOTH THE PURCHASE AND SALE OF SUPPLIES AND EQUIPMENT AT INGALLS. AS AGREED WITH YOUR OFFICE WE REVIEWED PROCUREMENTS FROM FIVE INGALLS SUBCONTRACTORS WHERE THERE WERE ALLEGATIONS THAT SOUND PROCUREMENT PRACTICES WERE NOT FOLLOWED.

IN SUMMARY, WE FOUND:

- AN AWARD TO OTHER THAN THE LOW BIDDER ALTHOUGH THE LOW BIDDER APPEARED TO MEET THE PROCUREMENT REQUIREMENTS;
- PREAWARD ACTIVITIES MAY HAVE BEEN CONDUCTED IN A MANNER TO INSURE AWARDS TO CERTAIN SUBCONTRACTORS;
- TWO INGALLS EMPLOYEES REQUESTED, RECEIVED, AND CERTIFIED THE RECEIPT OF SERVICES FROM A FIRM THEY HAD ESTABLISHED;
- A QUESTIONABLE AWARD TO A SUBCONTRACTOR BY INGALLS' PROCUREMENT OFFICIALS WHO SUBSEQUENTLY BECAME OFFICIALS OF THAT SUBCONTRACTOR; AND

--INGALLS MADE 22 AWARDS IN THE AMOUNT OF \$6.4 MILLION TO A SUBCONTRACTOR KNOWN TO BE EXPERIENCING FINANCIAL PROBLEMS.

THESE MATTERS ARE COVERED IN DETAIL IN OUR REPORT SUBMITTED TO YOU ON OCTOBER 23, 1973.

AS I STATED EARLIER, WE AGREED WITH YOUR OFFICE TO LIMIT THE NUMBER OF TRANSACTIONS EXAMINED SO THAT THEY COULD BE STUDIED IN SOME DEPTH TO ESTABLISH A CHRONOLOGY OF EVENTS AND FACTS SURROUNDING THE RELATIONSHIP BETWEEN THE INGALLS SHIPBUILDING DIVISION AND ITS SUBCONTRACTORS. THEREFORE, WE DID NOT EVALUATE INGALLS' PROCUREMENT SYSTEM BUT INSTEAD DEVELOPED THE SPECIFICS OF THE CASE STUDIES SHOWN IN OUR REPORT. BECAUSE OF THE RESTRICTED SCOPE OF OUR REVIEW, WE DO NOT BELIEVE ANY OVERALL CONCLUSIONS CAN BE DRAWN AS TO THE ADEQUACY OF INGALLS' SUBCONTRACTING PRACTICES.

ALTHOUGH OUR REVIEW SHOWS THAT QUESTIONABLE PROCUREMENT PRACTICES OCCURRED, WE WISH TO EMPHASIZE THAT THE FACTUAL DATA WE WERE ABLE TO OBTAIN DID NOT DEMONSTRATE THAT THERE WERE PAYMENTS OF FEES OR KICKBACKS. WE THEREFORE DID NOT HAVE A BASIS TO TAKE ANY RECOVERY ACTIONS UNDER THE ANTI-KICKBACK ACT (41 U.S.C. 51). THIS ACT PROVIDES FOR THE AGENCIES OR GAO TO DIRECT RECOVERIES OF KICKBACKS ON GOVERNMENT CONTRACTS. THERE WERE SOME INDICATIONS OF POSSIBLE VIOLATIONS OF FEDERAL CRIMINAL LAW, THEREFORE, THE REPORT WAS REFERRED TO THE DEPARTMENT OF JUSTICE TO DETERMINE WHAT FURTHER ACTIONS MAY BE APPROPRIATE, AS IS OUR NORMAL PRACTICE.

WE ARE CONCERNED, HOWEVER, ABOUT THE POSSIBILITY OF INCREASED COSTS TO THE GOVERNMENT BECAUSE OF QUESTIONABLE PROCUREMENT PRACTICES BY PRIME CONTRACTORS. THEREFORE, SEPARATE AND APART FROM THIS REPORT WE BROUGHT THESE MATTERS TO THE ATTENTION OF THE DEPARTMENT OF DEFENSE. POINTING OUT THE NEED FOR THE DEPARTMENT TO GIVE FURTHER ATTENTION TO THE ADEQUACY OF CONTRACTORS' PROCUREMENT PRACTICES. ALSO, WE RECOMMENDED THAT THE DEPARTMENT UNDERTAKE A REVIEW OF THE AGENCIES SURVEILLANCE PROCEDURES TO DETERMINE WHETHER THEY ARE ADEQUATE TO DISCLOSE PROBLEMS OF THIS NATURE AND WHETHER ADDITIONAL SURVEILLANCE PROCEDURES OVER CONTRACTORS' PROCUREMENT PRACTICES ARE REQUIRED. FURTHER, WE PLAN TO COVER THIS ASPECT IN OUR BROAD REVIEW OF PRIME CONTRACTORS' PROCUREMENT ACTIVITIES.

ADDITIONAL WORK BY GAO IN THE AREA OF
PRIME CONTRACTORS' PROCUREMENT ACTIVITIES

APPROXIMATELY 50 PERCENT OF GOVERNMENT PRIME CONTRACT DOLLARS REACH SUBCONTRACTORS THROUGH CONTRACTOR PURCHASING SYSTEMS. THIS COULD APPROXIMATE \$25 BILLION DOLLARS A YEAR.

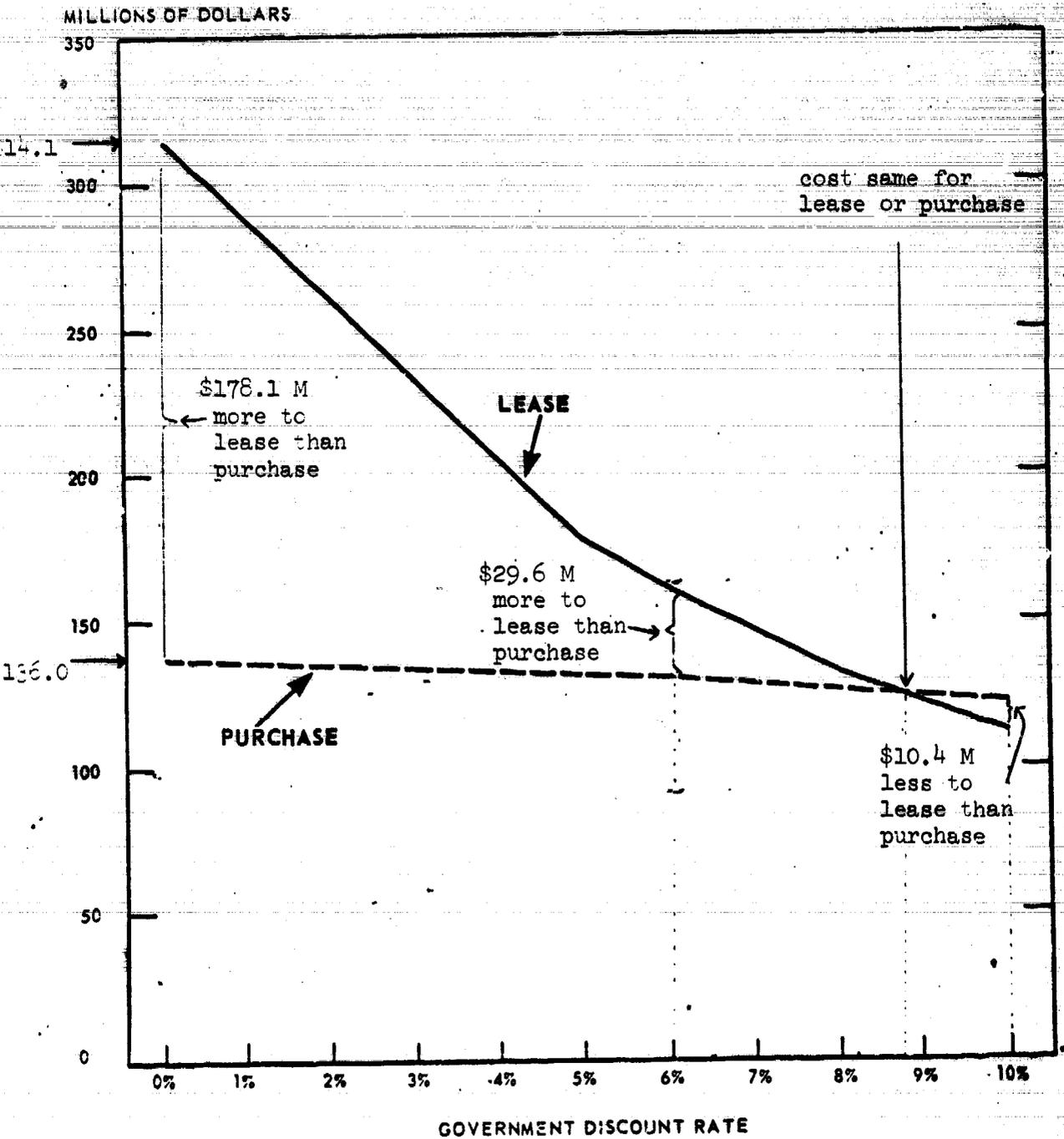
ALTHOUGH THERE IS NO DIRECT CONTRACTUAL RELATIONSHIP BETWEEN THE GOVERNMENT AND SUBCONTRACTOR, THE GOVERNMENT IS CONCERNED WITH THE BUSINESS RELATIONSHIP AND PRACTICES BETWEEN THE PRIME AND SUBCONTRACTORS, PARTICULARLY WHERE THEY CAN AFFECT COSTS TO THE GOVERNMENT. WE MUST CONTINUE TO ASSURE OURSELVES THAT THESE RELATIONSHIPS ARE NOT CONTRARY TO THE GOVERNMENT'S BEST INTEREST.

ALTHOUGH WE HAVE PREVIOUSLY PERFORMED WORK IN THIS AREA, WE ARE INTENSIFYING OUR EFFORTS CONCERNING THE ADEQUACY OF PROCUREMENT PRACTICES OF PRIME CONTRACTORS IN SUBCONTRACTING UNDER GOVERNMENT PRIME CONTRACTS. WE WILL APPROACH THIS AREA BY EXAMINING THE CHECKS AND BALANCES OVER THE PRIME CONTRACTOR'S PROCUREMENT SYSTEM OR WHAT THE AUDITOR CALLS INTERNAL CONTROL. INITIALLY, WE WILL SELECT SEVERAL LARGE (BY DOLLAR VOLUME) GOVERNMENT PRIME CONTRACTORS FOR EXAMINATION INTO HOW WELL THEIR PROCUREMENT SYSTEMS OPERATE.

IN ADDITION, WE WILL TEST THE EFFECTIVENESS OF SURVEILLANCE ACTIVITIES BY BOTH THE PRIME CONTRACTOR AND GOVERNMENT CONTRACTING AGENCIES.

THIS CONCLUDES MY STATEMENT, MR. CHAIRMAN, I SHALL BE PLEASED TO ANSWER QUESTIONS YOU OR THE OTHER MEMBERS OF THE SUBCOMMITTEE MAY HAVE.

**COMPARATIVE COSTS OF
LEASING vs. PURCHASING
NAVY TANKERS**



BEST DOCUMENT AVAILABLE



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-163058

OCT 30 1973

The Honorable F. Edward Hebert
Chairman, Committee on Armed Services
House of Representatives

Dear Mr. Chairman:

This is in response to a request from your office for a brief history, including our past and present recommendations and Department of Defense (DOD) actions taken in response to our recommendations, of the DOD Selected Acquisition Report (SAR).

As you know, the SAR improvements resulted not only from our recommendations but also from those of the Armed Services and Appropriations Committees of the Congress as well as DOD actions. The SAR improvements that we believe warrant early consideration by your Committee and DOD follow.

1. Precise criteria should be established for adding and deleting major acquisitions. (See pp. 9 and 10.)
2. Planning and development estimates that may change should not be deleted for any reason. SARs should contain a record of all estimates so that there is total visibility and trackability from the program's inception. (See p. 10.)
3. There is an undue delay in submitting SARs to top management through DOD. For several years SARs have been submitted to the Congress nearly 3 months after the "as of" dates. (See pp. 3, 4, and 9.)
4. All program costs should be included. A number of systems under development include only research and development costs. Procurement costs are excluded. Costs for these systems are therefore understated on SARs, and other systems are kept below the dollar criteria for consideration for SARs. (See p. 11.)
5. SARs should show a comparison of cost incurred, schedule milestones attained, and technical performance accomplished with what was planned for the same period of time and costs budgeted. (See p. 9.)

ORIGIN AND PURPOSE

DOD Instruction 7000.3 of February 23, 1968, established the SAR requirement. Before the SAR system was introduced, there were no summary recurring reports on major acquisitions which retained cost, schedule, and performance data for comparison with prior and subsequent estimates.

The SAR system's initial purpose was to keep its sponsor, the Assistant Secretary of Defense (Comptroller), apprised of the progress of selected acquisitions and to compare this progress with the planned technical, schedule, and cost performance.

During 1968 the SAR was in an experimental stage; only eight programs were reported on. In early 1969 the Secretary of Defense established an objective that he be advised regularly of the status of major acquisitions. Concurrently the Chairman of the Senate Armed Services Committee concluded that the Congress should also be regularly informed of the progress of DOD acquisitions and requested periodic reports on such programs. After all parties concerned held discussions, they decided that SARs would be used to advise top DOD management and the Congress of the progress of major acquisitions. As a result of this decision, the SAR became and remains the key recurring summary report from project managers and the services to inform the Secretary of Defense and the Congress on the progress of major acquisition programs.

INTEREST AND IMPROVEMENTS

Since inception the SAR system has been considerably changed and improved. During this time we have worked with DOD and the congressional committees on improving the system.

CONGRESSIONAL OPINION OF THE SAR SYSTEM

The following statements convey the general congressional feeling toward the SAR system.

The House Committee on Armed Services, in its report (91st Cong., 2d sess.), of April 24, 1970, stated:

"With valuable suggestions made by the Comptroller General, the SAR's are being improved to the point where they can become a significant aid to better program management.

"The manner in which these SAR's are presented to the Committee, however, leaves much to be desired.

"The Department of Defense has sometimes arbitrarily eliminated statistical information or otherwise altered the material submitted to the Committee."

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"The Committee is, likewise, disturbed by the timeliness with which these SAR's are submitted to the Committee by the Department of Defense. In many cases the Committee has not received the SAR's, * * * until as much as three months after the close of the reporting period. This greatly lessens their effectiveness to the Committee, particularly during the period when the annual authorization is being considered."

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"In its attempt to gain a more detailed portrait of military spending, the Committee has become concerned about the inconsistency of various reporting and estimating methods in relation to weapons costs."

"* * * The Committee has been presented with estimated unit costs for aircraft that vary by millions and millions of dollars, depending upon what costs are included or excluded, or what procurement level is provided, and, in some cases, on who is making the estimate. The Committee directs that the Department of Defense determine a consistent cost estimating procedure to be used by all departments * * * to provide a clear display of total program costs and unit costs of weapon systems.

"The Committee is also concerned about the lack of consistent procedures in making long-range cost projections. " * * * Since the fact of inflation is undeniable, it is obvious that an alleged cost growth will greet the program again next year. * * * The Committee believes that to make realistic long-range projections which could be truly useful to the Congress it is necessary to have some realistic measure of inflationary trends and the Committee believes that consistent factors should be used in all programs. * * *"

The Senate Committee on Armed Services, in its report (92d Cong., 1st sess.) of September 7, 1971, stated:

"Analyses of the quarterly reports received by the committee on selected major weapon programs with projected costs estimated at \$104.6 billion have proved extremely beneficial in assisting the Committee to maintain an oversight of the programs throughout the year and in deliberation on the fiscal year 1972 budget requests. Refinements to these reports have done much to improve the data and additional refinements are expected."

Most recently, the House Committee on Appropriations in its report (92d Cong., 2d sess.) of September 11, 1972, stated:

"The Committee finds it necessary to require improvement in the quarterly Selected Acquisition Report (SAR) in several respects, beginning with the timeliness of their submission. * * * The military departments and OSD [Office of the Secretary of Defense] have had sufficient time to familiarize personnel with this reporting document and to institute the mechanics and required staff for a more timely submission. There is little reason for the inordinate delays experienced in submitting SARs to the Committees."

* * * * *

"The Committee has noted that the initial development estimates and the initial planning estimates are being changed in the SARs. * * * The initial planning estimate is the first cost estimate that the Department of Defense brings to Congress for authorization and appropriation. It is recognized these early cost estimates may be incomplete but they should remain as static baselines of program cost and should not be deleted from the report.

"The section relating to additional procurement item costs needs considerable improvement. There should be firm baselines established with footnotes indicating the basis for these baselines, and any changes from these baselines should be provided in the form of a variance analysis.

"In the summary statement, some mention should be made as to the probability of the weapon system

achieving its primary mission or meeting original contract specifications. While the SAR does provide certain milestones * * * it does not provide sufficient data indicating the current status of the system development versus where it was planned to be at that given point in time."

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"Performance characteristics should be tailored to the specific key points of the weapon system, rather than uniform performance characteristics for a class of weapon system."

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"Current SARs do not now show total weapon system costs. For example, the cost of developing and manufacturing nuclear warheads by the Atomic Energy Commission (AEC, is not included in the weapon system cost even though the warhead and its cost is as pertinent as the weapon's propulsion system."

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"Many of the foregoing changes have been discussed during hearings last year and this year. * * * Therefore, appropriate changes are to be made in internal instructional documents and memoranda on the SAR reporting system to conform to the foregoing Committee request."

OSD has told us it has met with the House Committee on Appropriations regarding the Committee's needs and desires for data and SAR improvements. As a result of these discussions, DOD has taken actions to (1) send the Committee advance copies of SARs before submitting the final revisions, (2) provide additional information by including AEC costs in those SARs when applicable, and (3) reflect performance characteristics in future SARs tailored to specific key points of the system rather than uniform characteristics for a class of weapon systems. Otherwise DOD believes the current DOD Instruction 7000.3 satisfies the Committee's desires. Other areas of Committee interest will be discussed before changes are made.

DOD IMPROVEMENTS IN SARs

Since the SAR system was established in 1968, a great deal has been accomplished and the system has been considerably changed. DOD Instruction 7000.3 was revised in December 1969, June 1970, September 1971, and April 1972 to incorporate changes in the standard format and instructions to be followed by DOD components in responding to Secretary of Defense requirements for summary reporting of technical, schedule, quantity, and cost information concerning major acquisitions. Some of the principal improvements are cited below.

Definition of costs

In response to the House Armed Services Committee report of April 24, 1970, pointing out that DOD should provide a clear display of total program and unit costs of weapon systems, DOD developed a fact sheet concerning weapon system cost displays. It was submitted to the Committee and the services on May 19, 1970. DOD guidance to the services stated that the terms defined in the fact sheet should be uniformly applied but that DOD recognized that some realignment will be necessary within certain procurement line items to provide for complete consistency.

The fact sheet stated:

"* * * It is now our intent that this special vocabulary shall consist of four (4) terms which, if uniformly applied and understood, should go a long way towards alleviating the difficulties the committee has experienced. These terms are 'Flyaway Cost,' 'Weapon System Cost,' 'Procurement Cost,' and 'Program Acquisition Cost.' * * *"

"The terms 'Flyaway Cost,' 'Weapon System Cost,' and 'Procurement Cost' have application to the appropriations within the 'Procurement Title' of the DOD Authorization and Appropriation Bills. The basic method for presenting procurement requirements is the Weapon System Line Item Listing (Exhibit P-1) for the Appropriations Bill and its counterpart Section 412 Weapon System Line Item Listing for the Authorization Bill. It is intended that the line item should include all procurement costs required to acquire and initially deploy a weapon system except for its complement of initial spares, which is budgeted as part of a separate line item covering all initial spares for all systems. Within the individual

weapon system line item, those costs which are related to the production of a usable end item of military hardware are commonly referred to as 'Fly-away Costs.' This term has evolved in connection with aircraft and missile programs, although it should be understood that it equates to what could be called 'Rollaway' in the case of vehicles or 'Sailaway' in the case of ships. It includes the cost of the basic unit to be fabricated (airframe, hull, chassis, etc.), the propulsion equipment, electronics, ordnance, and other installed government furnished equipment.

"The balance of the individual weapon system line item contains those peculiar procurement costs required to deploy a system, such as ground support equipment, training equipment, publications, technical data, contractor technical services, etc. The sum of these two segments within the line item is referred to as 'Weapon System Cost.' As stated above, in order to arrive at the total amount within the Procurement Title related to the acquisition of a weapon system, we must add the associated initial spares to the 'Weapon System Cost.' The sum of these two amounts represents the 'Procurement Cost' which appears in the program acquisition cost section of the Selected Acquisition Report (SAR). This section of the SAR also contains those 'Research, Development, Test, and Evaluation (R,D,T&E)' and 'Military Construction (MILCON)' costs related to the acquisition of a weapons system. The sum of the RDT&E, MILCON, and 'Procurement Cost' represents the term 'Program Acquisition Cost.'"

Application of inflation

Also, in response to the Secretary of Defense's (Comptroller's) report of April 24, 1970, pointing out that some realistic measure of inflationary trends is necessary, DOD issued a memorandum on June 30, 1970, entitled "Weapon System Costing." It stated, in part:

"Cost estimates will reflect the best estimates of the amount ultimately to be paid, specifically incorporating anticipated changes in future prices. Wherever possible, this will be accomplished on the basis of specific data applicable to a given system, considering such factors as contract provisions, labor agreements, productivity and quantity

changes, and the extent to which material is on hand or under fixed-price contract. In other cases, it will be necessary to base the estimates on forecasts of changes in price levels."

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"The pricing policies set forth in this memorandum will be reflected * * * in the SAR's as of September 30, 1970 * * *."

Changes in data presentation

The SAR has been revised numerous times to provide for easier reading and analysis. The initial SARs prepared in 1968 and 1969 did not identify the program cost variance explicitly, and, as a result, cost growth could not be segregated by its various causes. Our February 6, 1970, report (B-163058) suggested that DOD give increased attention to the problem of identifying specific cost growth factors. Consequently DOD revised its instructions on June 12, 1970, to provide nine categories of cost variance for use in the SAR system.

In 1970 and 1971 SARs were rather voluminous, some with 60 pages or more. DOD, recognizing that management does not have the time to review and analyze such documents, revised DOD Instruction 7000.3 on September 13, 1971, to provide that no SAR would have more than 13 pages unless the Assistant Secretary of Defense (Comptroller) grants a special waiver and that 10 pages or less is desirable.

On May 25, 1972, the Assistant Secretary of Defense (Comptroller) issued new reporting requirements for the Logistic Support/Additional Procurement Cost section of the SAR. This letter stated, in part, that in the interest of uniformity and clarifying and simplifying the reporting requirement, only modification and component improvement costs will be reported. The instructions also stated that the period covered by these costs will be from program inception through either the last year of the Five Year Defense Program or the last year of procurement of the basic system, whichever is later.

OUR EVALUATIONS OF SAR SYSTEM

In 1969 we became involved in evaluating the SAR system and working with DOD and congressional committees on improving it.

Results of our initial review of the system, undertaken in August 1969, were published in our report entitled "Status of the Acquisition of Selected Major Weapon Systems" (B-163058, Feb. 6, 1970).

That report concluded that the system, in concept, represented a meaningful management tool for measuring and tracking the progress of major acquisitions. Like any new reporting system, the SAR system had some serious shortcomings. SARs had failed to show such significant information as (1) a comparison of demonstrated performance with that specified in the contract, (2) the status of key subsystems essential to mission accomplishment, (3) costs incurred in relationship to the costs planned to be incurred, (4) significant pending decisions that may affect the program, and (5) a comparison of quantities delivered with those scheduled to be delivered at the same time.

Results of our second review of the SAR system, undertaken in August 1970, were published in our report entitled "Acquisition of Major Weapon Systems" (B-163058, Mar. 18, 1971). That review confirmed that improvements had been made since our first report was issued but that improvements were still needed. We concluded that SAR still did not (1) contain a summary regarding overall acceptability of the weapon for its mission, (2) recognize the relationship of other weapon systems complementary to the system, or (3) reflect the status of programs.

In August 1971 we initiated our third review of the SAR system, which was directed toward evaluating its value to management. While DOD was continuing to improve the system, two principal problems identified related to changing baselines for measuring progress and credibility of cost estimates. We concluded that static baselines should be reported and maintained in the SAR and that complete and realistic cost estimates were needed. Both are essential in evaluating the progress of major acquisitions and in making decisions on the system's future progress. In addition, we concluded that (1) a recurring problem was the undue delay in submitting SARs to top management through DOD and (2) the criteria for designating weapon systems for SAR reporting should be reassessed, to improve management visibility on additional major weapon systems. The conclusions were published in our report entitled "Acquisition of Major Weapon Systems" (B-163058, July 17, 1972).

In February and March 1973 we issued 68 staff studies to the Congress evaluating SARs on applicable systems. An

analysis of our work indicates that more precise criteria should be established for including major acquisitions for SAR reporting. DOD Instruction 7000.3 provides that SARs are required for all programs designated as major by the Secretary of Defense and will usually be those programs which require a total of \$50 million for RDT&E or \$200 million for procurement. Other systems not qualifying under these dollar guidelines may be designated for SAR coverage by the Secretary.

Though criteria for SAR reporting should include dollar limitations, the above dollar criteria by themselves may preclude systems critical to the national defense from being included or even from being considered for SAR reporting solely on the basis of minimum dollar limitations. Thus the urgency of need should also be included in the criteria for SAR reporting. In addition, factors should be included in the criteria to specify when in the acquisition process systems should be added or deleted.

DOD has no formal process for deciding whether a major system should be included in the SAR system. We were informed that systems are selected for the SAR system on the basis of recommendations from the services or OSD and/or on the basis of interest in a system by the Congress or GAO.

Establishing and monitoring baselines for major acquisitions continues to be one of the most significant problems which must be resolved to improve the SAR as a key information report. To measure program progress, management must have a baseline. At the outset of any program, a planning estimate is established and periodically changes as the program progresses. The initial planning estimates could be reported as ranges of dollars. Once the planning estimate becomes static, it should not be changed and should remain on the SAR for tracking purposes.

A similar approach could be taken with the development estimate. It could be labeled as "initial" and stated as ranges of probable cost until the development contract was awarded. Subsequently, the development estimate should remain static.

Adding a production estimate to SARs should also be considered. This would be "initial" until the production phase begins, just after DSARC III, and would become static once the production contract is awarded.

The current estimate through completion would remain as is. This approach should be taken with the Logistic Support/Additional Procurement cost section of SARs.

In this manner, the estimates would be more meaningful to SAR readers and users. There would be greater visibility over the life of the program because historical tracking would be enhanced.

Also certain SARs prepared for systems in the early stages of acquisition did not show procurement costs. SARs should include all program costs, even in these early stages.

As you know, we are continuing to monitor a number of major acquisitions and will make further suggestions to DOD and the Congress to improve SARs.

We trust that this information will satisfy your needs.

Sincerely yours,

A handwritten signature in black ink, appearing to read "James B. Adams". The signature is written in a cursive style with a large initial "J".

Comptroller General
of the United States